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REAL ESTATE

Vol. 1, No. 7 July 1988

OUTLOOK

A Monthly Forecast for the Economy and Real Estate

FORECAST SUMMARY

- Real GNP growth in the first quarter was revised downward to 3.6 percent from 3.9 percent. The June downward revision was primarily due to a slowdown in the estimated rate of advance of consumer spending in the first quarter.
- The trade deficit fell in April to the slimmest margin in more than three years. The $9.9 billion figure indicates that the trade deficit is finally getting some relief from the weaker dollar as imports actually decreased by 6 percent in April.
- Increased demand for U.S. goods, both at home and abroad, has been pushing U.S. manufactures to near capacity levels. Although re-tooling efforts are underway in many industries, only time will tell if capacity can be expanded far enough and soon enough to minimize shortages and price increases.
- A severe drought has raised expectations that food prices will be higher later in the year, triggering price increases on a variety of food items. The drought has also increased expectations for higher rates of inflation which has in turn put upward pressure on mortgage interest rates.
- May sales of existing homes rose for the fourth consecutive month to a seasonally adjusted rate of 3.63 million units, with advances in every region across the nation. This steady rise seems to be fueled not only by the traditional springtime homebuying season, but also the belief that interest rates could be heading higher.

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SAY GOODNIGHT, GRACIE

Economic Commentary

by
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The crash was supposed to plunge the economy into recession; it didn't. The falling dollar was supposed to unleash runaway inflation reminiscent of the 70s; it didn't. Our declining productivity and profligacy as a nation was supposed to subjugate our economy to the rest of the world; it hasn't. What's going on here?! While economists have occasionally been more spectacularly wrong, never have they (whaddya ya mean *they*, Kimo Sabe?) been so consistently wrong in so many small ways.

It's not time to give up on the usefulness of economic analysis as a tool for arranging public life, but it is time to consider how the changes that have occurred and are occurring in the American economy have escaped the consideration of the profession's main stream. In brief, economists have been wrong so much recently because they rely on models for most of their analysis, because these models have been inadequate to deal with change of the dimensions we have seen, and because, when the models have not worked, the economists have tried to wing it. And those of you who have heard the myriad of economist jokes know, improvisation is not a natural state for most of the dismal scientists.

Each of these aspects requires some elaboration, so, as the local sportscaster is wont to say, let's go to the video tape.

Economists believe in models. This is probably the backbone of practicing economics. Abstractions have been a common source of commentary since Aesop. But often abstractions can fail to capture the real guts of the issue and then may lead to useless advice, e.g., how can one look before leaping if they who hesitate are lost? In some sense, this is happening now. Models which rely on wealth to predict economic activity (a fairly common variety) would have concluded that the stock market crash would have unleashed a recession of proportions unprecedented since 1929, and indeed this is what we read about for a good two months after the crash. In fact, the distribution of wealth is such that this was not the case. What is missing most often from models is common sense. It is, for example, far more useful to forecasting to consider whether one's driving is impeded by public works projects (a sure sign of prosperity, since state and local governments are most active when the economy is best), rather than looking at the quadratic reaction function (I'm not kidding here) of monocentric economic agents. When the latter is more important than the former, economists will be wrong.

Models can be wrong. As the economy changes fundamentally, models must similarly change. Keynesian economics, born of the failures of other models during the Great Depression, is a prime example here. We simply need to see things with a different eye. Right now, there are some real changes going on in the American economy that may require some revisions in the way we look at what goes on. A good case in point is the unemployment rate. In the Seventies, an unemployment rate of 5.5 percent would have been the signal for severe pressure on prices, because at that rate, the economy would be overheated. So, when the unemployment rate reached that level earlier this year, the models said that inflation was going up quickly. In fact, the population structure of this country has shifted during the Eighties to the degree that we can easily sustain an unemployment rate of 5.5 percent *or lower* without seeing inflation rise like Godzilla from some volcano. In the economics profession, there is some real questioning of conventional wisdom. While that questioning proceeds, forecasting is going to be far less accurate.

Economists wing it. John Kenneth Galbraith once said that economists forecast not because they're good at it, but because people ask them to. And lately, more and more people are asking. As financial news becomes more interesting and important to the general public and as the outlets for this news increase, more and more economists are being asked to comment on every little statistic. With the models we use, every little statistic is not forecast. Combine this with the fact that the models have been shaky lately, and you've got the case where economists have to think on their feet about what's going on. Often it doesn't work. Their answers are dull, incomprehensible, wrong, or all of the above. In fact, the more esteemed the credentials of the economist, the more learned and academic the background, the more "scientific" the models are, the worse are the answers.

Having trashed my own profession, I think it only fair to soften up a bit. What I am really suggesting is that most of economics, at least from the perspective of the general public, is common sense. Too much, the profession relies on spatial location models to determine the best markets, rather than asking regional franchise managers where they will be placing their franchises and why. To be useful (if that is the goal), economists need to develop a common sense touch that will translate their own knowledge and insight into terms that will make it available to their consumers. And when changes are occurring and the models are giving out less reliable information, that common sense is simultaneously more useful and more elusive.

In a sense, the scientific economists are the Harry Von Zells and Blanche Mortons of the world dealing with Gracie Allen. In her own cockeyed way, Gracie saw more of reality more accurately than they could with their more conventional frames of reference. Although Gracie's strings of logic were as convoluted as DNA, they were always grounded in some observation of the real rather than some assumption. I think, in essense, she is a useful guide to the times. Of course, the real economist of the bunch was George Burns, who translated those strings of logic for the rest of us! Goodnight, Gracie.

Outlook for the Economy and Real Estate

THE ECONOMIC OUTLOOK

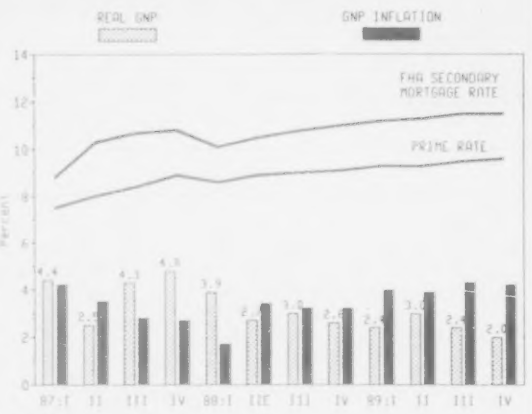
The Gross National Product (GNP) advanced at an inflation-adjusted annual rate of 3.6 percent in the first quarter, according to revised estimates from the Department of Commerce. Last month, first quarter growth had been revised upward to a 3.9 percent annual rate from the April estimate of 2.3 percent. The June downward revision (from 3.9 to 3.6 percent) was mainly due to a $3 billion reduction in the rate of advance of consumer spending. Personal consumption expenditures grew at an annual rate of 3.8 percent, instead of the previous estimate of 4.3 percent. In contrast, the revision for corporate profits from current production in the first quarter was $1.0 billion higher than previously estimated. However, even with the upward revision, corporate profits shrank $2.1 billion in the first quarter. Domestic profits of nonfinancial corporations can be credited with most of the revision's increase, climbing $9.1 billion in the first quarter, up from its $3.1 billion preliminary estimate, and well above its fourth quarter decrease of $6.9 billion.

Finally, the J-Curve

The April trade deficit fell to a surprisingly narrow $9.9 billion, the slimmest margin in more than three years. And if one month's data does not a trend make, consider this: the merchandise trade gap for the first three months of 1988 was $47 billion (seasonally adjusted annual rate), a fat 15 percent below the same statistic for 1987. Since the dollar's fall began in February 1985, expectations of a sharply improving trade deficit have been frustrated by a number of factors, including profit cutting by foreign producers to maintain market share, and of course the economics principle that trade imbalances lag currency changes. But really, it all boils down to simple arithmetic; call it the "Law of Large Numbers". The dollar value of U.S. imports has been running nearly twice that of U.S. exports, meaning that even a small, steady rise in imports can offset a faster rise in exports. The result is a widening nominal trade deficit, despite strong export growth. Now it seems the recent surge in exports may have begun to overwhelm the import rise. And the April numbers on imports gave a welcome boost: U.S. imports actually declined by 6 percent from the March total. This forecast does not anticipate that imports will steadily decline in the coming months, but the recent data does suggest a slower rise in value. The benefit is two-fold: exports get a leg up on the "Law of Large Numbers", and April's data on imports could mean that U.S. consumers are beginning to shift their preferences away from imports and back to American made goods.

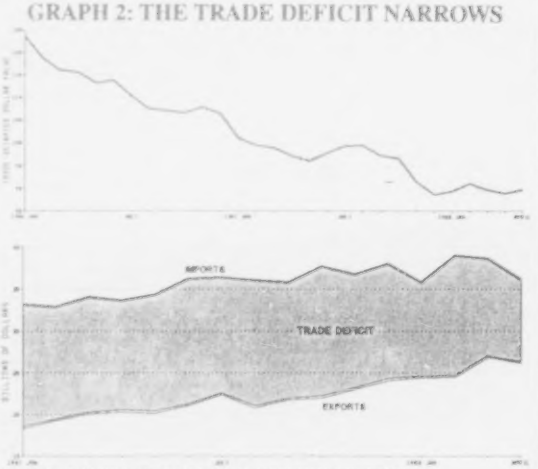
Graph 3 shows the trend in trade that is hidden behind the monthly trade deficit numbers. The graph shows how the *volume* of exports has risen relative to that of imports when compared on a percent change from prior year basis. By this measure, the first quarter data shows the volume of U.S. exports has risen almost one-third above its 1987 first quarter level. In contrast, the volume of U.S. imports has advanced less than 10 percent over the same period. With a growth differential of this magnitude, then the U.S. trade picture could become increasingly bright: even to the point of expecting a trade surplus by 1990.

GRAPH 1: THE ECONOMIC OUTLOOK



E NAR estimates(1988:II thru 1989:IV)

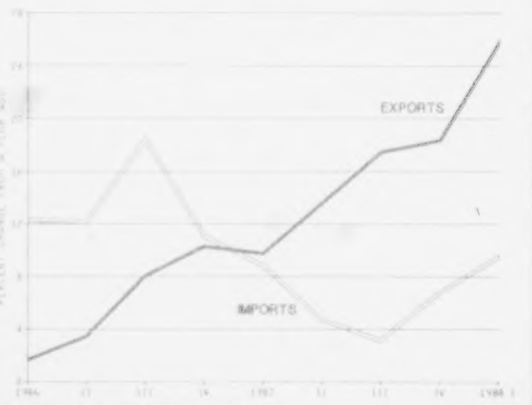
GRAPH 2: THE TRADE DEFICIT NARROWS



SOURCE: ADVANCE REPORT ON U.S. MERCHANDISE TRADE

GRAPH 3: A TRADE SURPLUS BY 1990?

(PERCENT CHANGE IN THE VOLUME OF TRADE)



SOURCE: BUREAU OF ECONOMIC ANALYSIS.

The Heat Is On At U.S. Manufacturers...

Greater demand for U.S. exports means that U.S. businesses must now serve two masters. First, they are faced with satisfying the demands of foreign consumers for less expensive American goods. At the same time, U.S. businesses are also trying to woo the American consumer away from higher-priced imports. This is complicated in industries like the auto industry where U.S. manufacturers have followed foreign price increases with price hikes of their own. On the whole, however, U.S. manufacturers are operating their plants at near capacity levels in response to the increased export demand. Re-tooling efforts are underway in many industries, but only time will tell if enough new capacity can be brought on line to minimize shortages. Already shortages of needed component parts are raising the possibility of more price hikes at the intermediate level. In short, the explosive growth in export demand is a positive development only to the extent that U.S. manufacturers can react to the increased production requirements without resorting to rationing products through much higher prices.

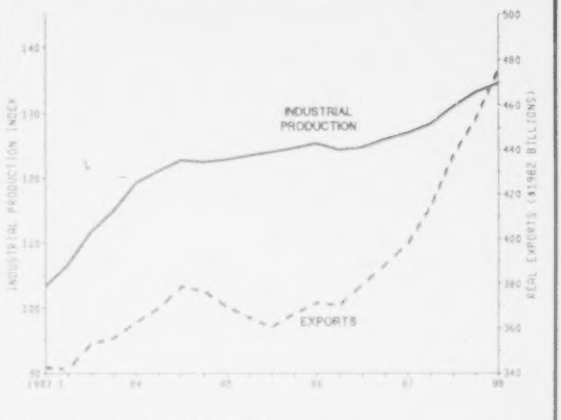
And They Plan To Do Something About It

Evidence of the re-tooling effort underway at the nation's factories has shown up in recent government surveys. The U.S. Bureau of Economic Analysis surveyed businesses in the first quarter of 1988 regarding their plans to spend for new plant and equipment this year. According to the first quarter survey, U.S. businesses *plan* to spend $423 billion for new plant and equipment this year, $4 billion more than they estimated when last surveyed (during the fourth quarter of 1987). If realized,this $423 billion would represent a 9 percent gain over their 1987 *actual* expenditures. For comparison, the 1987 total marked only a 2.4 percent rise over their 1986 *actual* expenditures. However, as businesses fail to realize their planned expenditures, the tendency is to not adjust the annual estimate until yearend. Nevertheless, the survey underscores the fact that U.S. manufacturers realize the need to expand plant and equipment in order to meet the enormous demand for exports.

Inflation Outlook May Depend on Food Prices

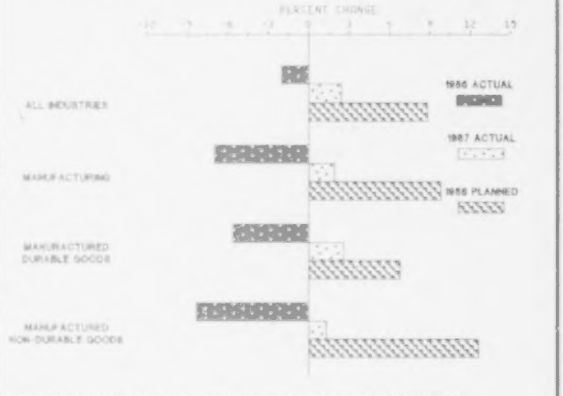
How successful U.S. businesses are at expanding capacity to handle the increased demand for exports is one of the key determinants in the outlook for inflation. If capacity constraints continue, the inflation rate may rise on account of shortages and higher wage demands. A new variable in the inflation outlook is the path food prices will take in the coming months. A severe drought gripping the Farm Belt has raised fears that crop yields will be sharply reduced and meat supplies similarly affected. The expectation that food prices will be higher later this year has already triggered price increases on a variety of food items. But these early price effects should not be taken as the leading edge of a broad and rapid rise in food prices. The reason is twofold: first, a shortage of grains will likely be absorbed somewhat by stockpiles; second, the full effects of higher prices on primary goods like grains take time to work through the production process. The current forecast raises the inflation rate slightly in the second half of 1988 to account for the rise in food prices.

GRAPH 4: INDUSTRIAL PRODUCTION KEEPS PACE WITH RISING EXPORT



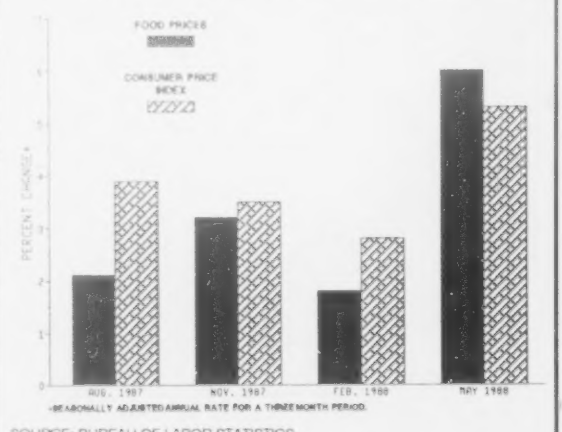
SOURCE: BUREAU OF ECONOMIC ANALYSIS.

GRAPH 5: INCREASED DEMAND FOR US GOODS PUSHES INVESTMENT PLANS HIGHER



SOURCE: SURVEY OF CURRENT BUSINESS, DEPT. OF COMMERCE

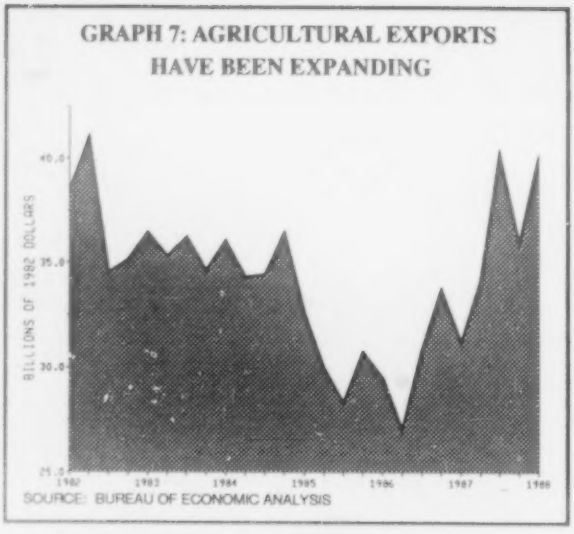
GRAPH 6: FOOD PRICES ARE ON THE RISE



*SEASONALLY ADJUSTED ANNUAL RATE FOR A THREE MONTH PERIOD.

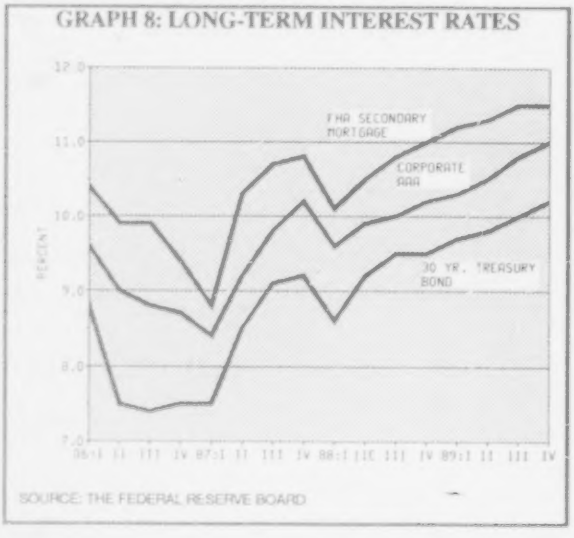
SOURCE: BUREAU OF LABOR STATISTICS.

The real cost of the drought, however, may be a longer-term weakening of the U.S. farm trade position. U.S. farm exports are not only important to the agricultural sector, they have also been a key surplus component in the U.S. trade balance. As the graph shows, U.S. farm trade suffered from the high value of the U.S. dollar in the early 1980's, making a modest rebound in 1986 that accelerated through 1987 and still looks good so far in 1988. In fact, foreign buyers of U.S. farm exports are now rushing to place orders before prices accelerate. And even if prices do rise, these higher prices could potentially offset the anticipated decline in volume. But despite this possibility and the presence of stockpiles, a severe drought will almost certainly derail plans for the U.S. to regain its dominant role in world agricultural trade. Already, some large deals with foreign importers have had to be scuttled because the U.S. government would have had to make large subsidy payments.



Inflation Pushes Up Long-term Rates

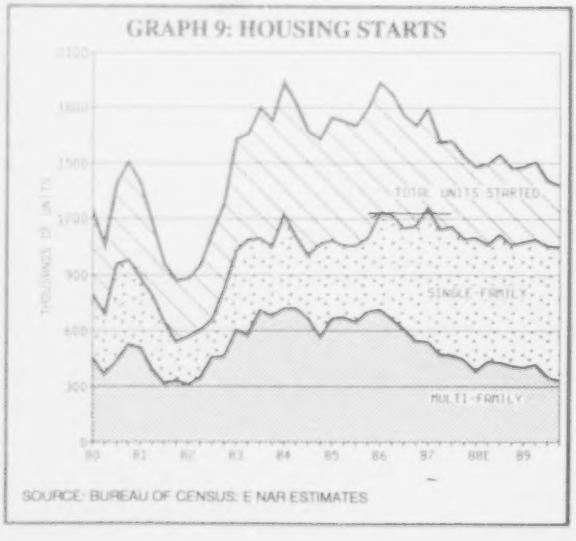
While the drought leads to poor expectations about the prospects for growth in U.S. agricultural trade it is also adding to expectations of faster rates of price increases. In turn, these expectation are keeping upward pressure on mortgage interest rates. Through much of 1987, the principal cause of faster inflation was expected to come from rising prices on U.S. imports, while domestically driven price increases were not thought likely because the U.S. economy was growing at a sluggish rate. Because of the explosive export growth, U.S. economic growth in 1988 has been considerably faster than expected, setting the scene for domestically driven inflation. Capacity constraints being reached at many U.S. manufacturers, expectations for higher wage settlements, and now higher food prices, are all contributing to the general belief that inflation is heating up. Although the measures of inflation are staying within a moderate band of 4-5 percent, it is inflation *expectations* that feed into mortage interest rates. Therefore, this forecast projects the secondary market yield on FHA mortgages will surpass 11 percent by the end of 1988, and average 11.3 percent in 1989.



REAL ESTATE MARKETS

Housing Starts

The seasonally adjusted annual rate of housing starts was 1.384 million units in May, a 12 percent decline from the April annual rate of 1.576 millions units. The May annual rate was 13.5 percent below the May 1987 annual rate of 1.599 million units. Single-family housing starts fell to 988,000 units, 9.2 percent below the April annual rate of 1.088 million units. Multi-fimily housing starts declined by 18.9 percent to an annual rate of 396,000 units in May. Of these, starts of structures with five of more units fell to an annual rate of 333 thousand units, 22.6 percent below the April annual rate of 430 thousand units. Starts of structures with two to four units bucked this trend, rising to an annual rate of 63,000 units in May, 8.6 percent faster than the April rate of 58,000 units. The current forecast projects that rising mortgage interest rates will continue to dampen housing starts activity in 1988(1.495 million units) and into 1989(1.450 million units).



New Home Sales

From February to April the rate of new single-family home sales consistently advanced. This trend finally came to an end in May with new single-family home sales dropping slightly to an annual rate of 658 thousand units, down 0.3 percent from the April rate of 660 thousand units. However, May also witnessed the end to another trend and, for the first time in nine months, the new single-family home sales rate rose *above* the rate of the previous year, increasing 1.4 percent from the May 1987 annual rate of 649 thousand units. The only region to suffer any real losses was the Northeast, where the sales rate fell 7.3 percent to an annual rate of 101 thousands units. This decline more than offset the 6.4 percent sales gains experienced in the Mid-west. In both the South and West sales remained relatively unchanged, at 271 thousand units and 185 thousand units respectively.

Existing Home Sales

Sales of existing single-family homes rose in May to a seasonally adjusted annual rate of 3.63 million units, a 3.1 percent gain over the April annual sales rate of 3.2 million units. After falling almost 5 percent in January, the annual rate of single-family home sales has risen steadily in each succeeding month. Further, May marked the second straight month in which existing homes were sold at the fastest pace of the preceding twelve months.

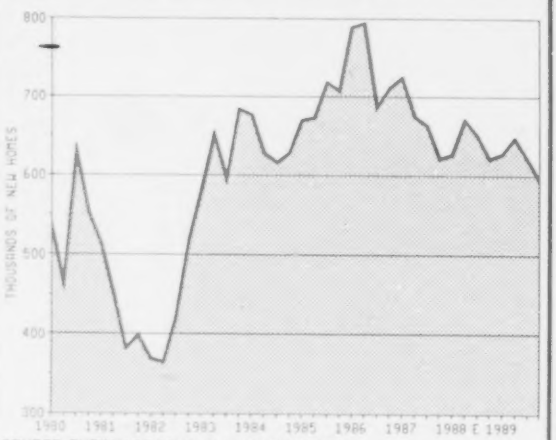
The May existing home sales rates advanced in every region across the nation. The Northeast region recorded the largest advance, moving up 10.4 percent in May to a seasonally adjusted annual rate of 740,000 units, 1.4 percent faster than the May 1987 annual rate. Sales in the Midwest advanced by 3.2 percent in May to an annual rate of 960,000 units, but were 1.8 percent slower than the May 1987 annual rate. The forces behind this steady rise in home sales seem to extend beyond the traditional springtime homebuying season. One of these forces is the belief that long-term interest rates could be headed higher, despite the upcoming presidential election. However, the rate rise is not expected to strangle home sales. Rather, a gradual rise in long-term rates will probably cause a moderate slowdown in home sales rates to about the 3.4 million unit level during the remainder of 1988. Existing single-family home sales are expected to total 3.37 million units in 1988.

Home Prices

The Median price of an existing single-family home rose to $88,600 in May, a 1.5 percent gain over the April median price of $87,300. Every region of the country shared in the price advance: the median price in the Northeast rose 11.0 percent to $148,700; the West up 10.2 percent to $122,000; the Midwest up 2.7 percent to $68,300; and the South up 1.6 percent to $83,100. The national median price of an existing single family home is expected to reach $89,700 in 1988, a 4.8 percent rise over the 1987 median price of $85,600.

Sean A. Burns
Research Economist
Forecasting & Policy Analysis Division

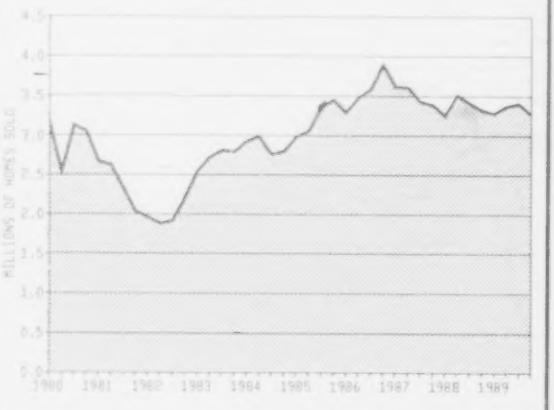
GRAPH 10: NEW HOME SALES



SOURCE: BUREAU OF CENSUS; E NAR ESTIMATES

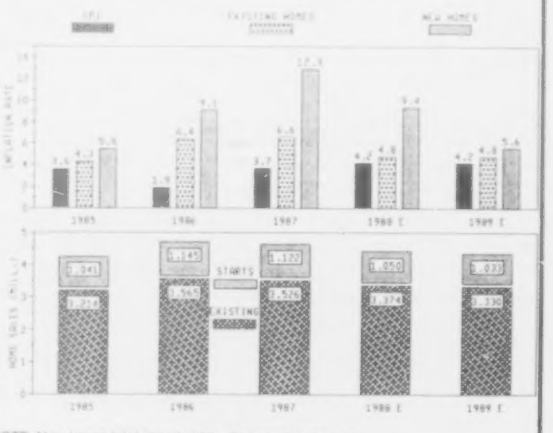
GRAPH 11: EXISTING SINGLE-FAMILY HOME SALES

(SEASONALLY ADJUSTED ANNUAL RATES)



SOURCE: NAR ECONOMICS AND RESEARCH; E NAR FORECASTING & POLICY

GRAPH 12: HOME PRICES



NOTE: New home total equals 97% of single-family starts.

BUILDING A NATIONAL HOUSING POLICY FOR THE 1990s AND BEYOND

by
Frederick E. Flick
Division Vice President
Forecasting and Policy Analysis

Introduction

Over the past decade, some disturbing trends in the state of the nation's housing have developed:

- The after-tax cash cost of homeownership, which peaked in the early 1980s, is still very high.
- The homeownership rate has declined steadily since 1980, especially among households in the 25-34 age range.
- Inflation-adjusted gross rents are at their highest level in two decades.
- The supply of low-cost rental housing is shrinking due to abandonment or upgrading for higher-income occupants.
- The increased rental payments burden, especially among single-parent families, has contributed to the rise in homelessness.

These trends have been affecting the ability of low- and moderate-income families to find acceptable rental housing and moderate- to middle-income families to make the transition from rental housing to homeownership. The ability for moderate income families to become homeowners over the past four decades has been called "The American Dream." Researchers and policymakers across the country are asking whether our society will continue to help families achieve this dream and, over the past year, have been providing input into the legislative process to help develop a new national housing policy. This article documents the empirical evidence relating to the decline in homeownership, increased costs of owner-occupied and rental housing, and impacts on various demographic segments of the housing market.

The Homeownership Rate

The homeownership rate, measured in the Census Bureau's *Current Population Survey*, is the percentage of housing units that are owner-occupied. Since the mid-1960s, it steadily rose from 63 percent to a high of 65.6 percent in 1980. However, since then, it has dropped to 64 percent. Although, this decline seems small in percentage terms (2.6 points), with almost 90 million families occupying individual housing units, it suggests a loss of roughly 1.44 million owners. Certainly, if the rate of homeownership had continued to increase through 1987, we could expect upwards of 2 million more homeowners than we have now.

The decline in the homeownership rate is a nationwide phenomenon affecting areas with strong and weak economies alike. However, there is a regional side to the problem, as well:

- The homeownership rate has fallen off most sharply in the Midwest, though marked declines occurred in the South and the West as well.
- The growth in the number of elderly homeowners in the Northeast helped offset the effect of declining homeownership rates of young households. In the Northeast, many older households have owned their homes for years and have therefore been insulated from the housing cost inflation of the late 1970s and early 1980s.

But, the most critical aspect of the problem is the concentration of the decline among younger households:

- For households aged 25 to 29, the homeownership rate fell from 43.3 percent in 1980 to 35.9 percent in 1987.
- Households aged 30 to 39 suffered similarly sharp declines.
- Even those in the 45 to 54 age group had a 5.5 percent decline.
- Only those in the 55+ age grouping experienced increases in their ownership rate.

Reasons for the Decline in Homeownership

High Cash-Cost of Owning

A recent study by the Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing 1988*, documents the increasing after-tax cash cost of homeownership and the increasing gross burden of rents as the major factors. The high costs of renting are preventing potential homebuyers from accumulating the resources needed to make downpayments and meet initial year carrying costs to own a home.

The Harvard study shows that the after-tax cash cost (mortgage payment plus property tax, insurance, fuel and utilities, and maintenance costs less tax savings of homeownership) for potential first-time homebuyers (defined by median income married couple renters aged 25 to 29) rose from a low of 22 percent in 1967 to the mid- to high 30 percents in the late 1970s; was 45 percent during the housing recession; and was 32 percent in 1987. The total burden (including the after-tax cash cost plus the opportunity cost of the downpayment, amortization

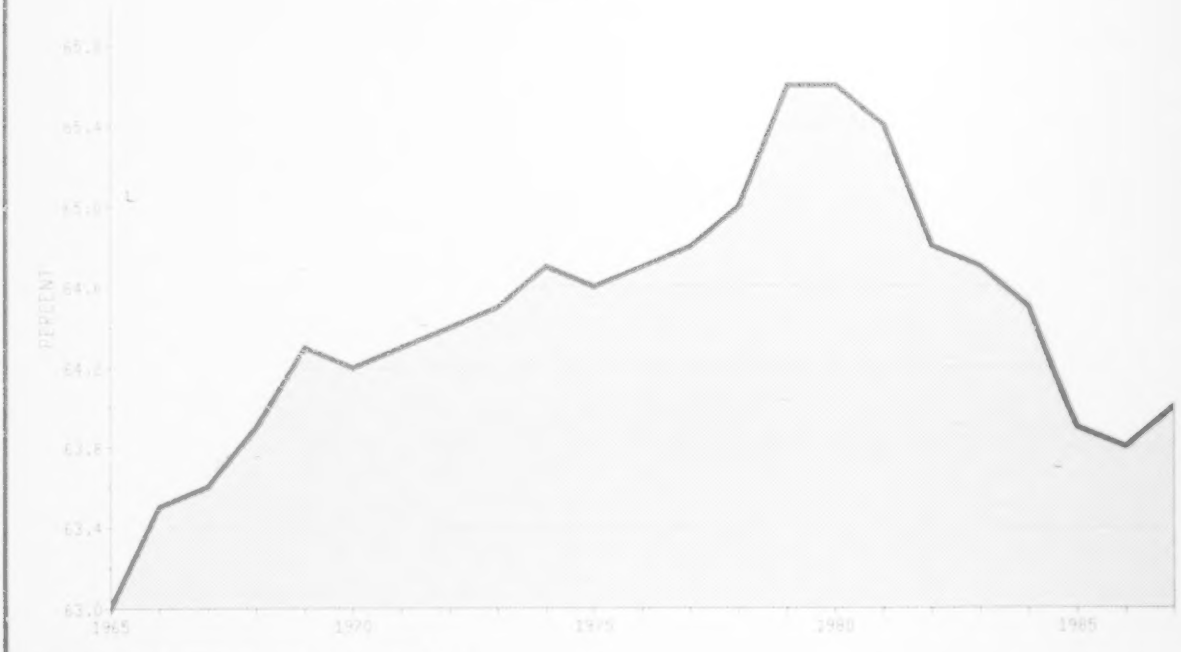
HOMEOWNERSHIP RATES

(PERCENT HOMEOWNER)

	1973	1976	1980	1983	1987
Region					
Northeast	59.2%	59.8%	60.7%	61.4%	61.4%
Midwest	69.1	69.5	70.3	70.0	67.1
South	66.5	66.4	68.3	67.1	66.9
West	60.6	61.2	60.5	58.7	57.9
Age					
Under 25	23.4%	21.0%	21.3%	19.3%	16.1%
25-29	43.6	43.2	43.3	38.2	35.9
30-34	60.2	62.4	61.1	55.7	53.2
35-39	68.5	69.0	70.8	65.8	63.8
40-44	72.9	73.9	74.2	74.2	70.6
45-54	76.1	73.9	74.2	74.2	70.6
55-64	75.7	72.7	75.2	76.9	78.1
65-74	71.3	72.7	75.2	76.9	78.1
75 +	67.1	67.2	67.8	71.6	70.7
TOTAL	64.4	64.8	65.6	64.9	64.0

SOURCE: 1973 to 1980 from Annual Housing Survey, 1983 to 1987 from Current Population Survey.

HOMEOWNERSHIP RATE, 1965 TO 1987



SOURCE: U.S. BUREAU OF THE CENSUS.

and closing costs, less expected equity buildup) is lower, due primarily to expected the equity buildup from homeownership. However, in order to secure equity, a potential homebuyer must qualify to carry the cash cost burden. Thus, the downpayment is the major factor which determines the mortgage amount and therefore the monthly principal and interest payment. Saving for the downpayment has been a major problem for many renters who are potential homebuyers.

Increased Rental Burden

The Harvard study also documents the substantial increases in the gross rent (contract rent plus fuel and utilities, property taxes and insurance) burden for various categories of households by age and family type.

- In the mid-1970s only single parents with children had rent burdens over one-third of their income. Single householders and married couples all had rent burdens ranging from 14 to 19 percent of income.
- However, by the 1980s, things had changed significantly. The gross rent burden for single parents aged 25 to 34 had increased to 58 percent of their income. For married couples with children, rents moved from 17 to almost 22 percent of income; and, even married couples without children had to pay almost 18 percent of their income for rent.
- In 1987, even single elderly, at a 42 percent gross rent burden, are better-off in rental housing than are single parents with children.
- For the 35 to 44 age group, 1987 rental gross burdens are the lowest across all groups, even single parents with children pay under one-third of their income for rent.
- Households under 25 carry some of the highest gross rent burdens of all groups; however, their situation in the mid-1970s was bad as well.

Conclusions

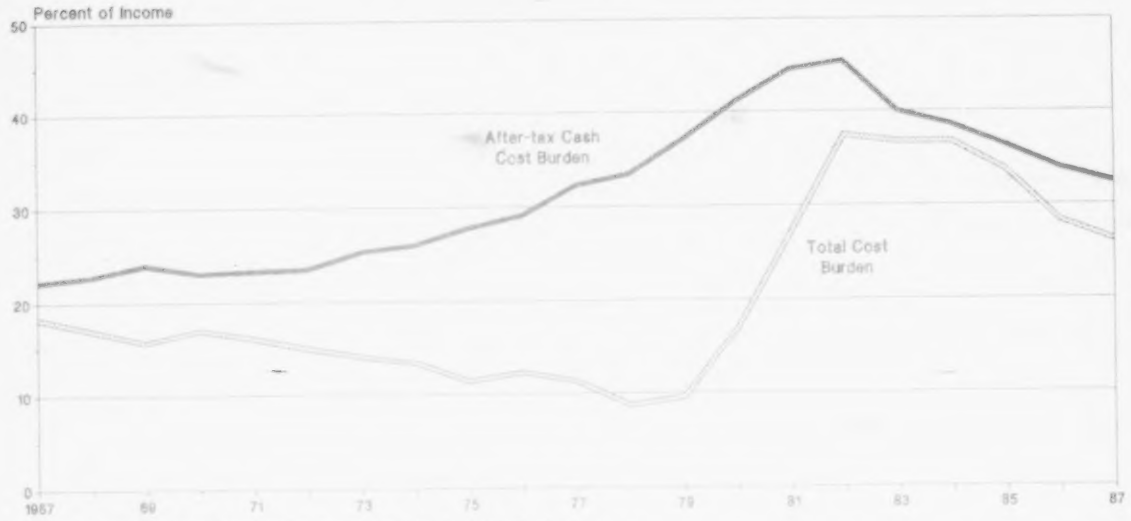
Since the mid-1970s there has been a substantial worsening in the housing situation of low- to moderate-income renters and potential first-time homebuyers. Although young married-couple renters earn more than other renters, their incomes have not kept pace with homeownership costs.

The relatively low incomes of renter households have important implications for housing in America. Low incomes limit the ability of many households to secure adequate and affordable housing in the non-subsidized private marketplace. They also shrink the pool of potential first-time homebuyers. With the incomes of young renter households failing to keep pace with inflation, the construction and sales of housing targeted to first-time buyers will suffer.

These conclusions suggest the need for a new look at national housing policy and for the development of innovative solutions to these problems.

FIRST-TIME HOMEBUYER COST BURDEN

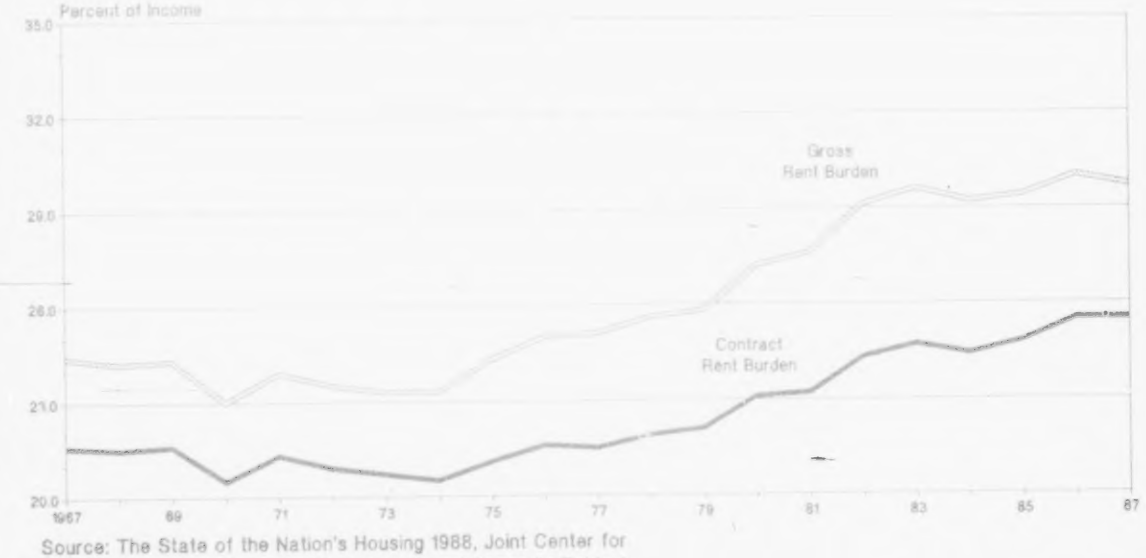
(COST AS A PERCENT OF INCOME)



Source: The State of the Nation's Housing 1988, Joint Center for Housing Studies of Harvard University, P.9 and Appendix Table 1.

RENTAL COST BURDEN

(COST AS A PERCENT OF INCOME)



Source: The State of the Nation's Housing 1988, Joint Center for Housing Studies of Harvard University, P.9 and Appendix Table 1.

RENT BURDEN BY AGE AND FAMILY TYPE

	MEDIAN INCOME (1986 DOLLARS)		GROSS RENT (1986 DOLLARS)		GROSS RENT BURDEN	
Age and Family Type	1974	1987	1974	1987	1974	1987
Household Head Under 25						
Single	$11,732	$12,437	$287	$318	29.3%	30.7%
Married With Children	18,608	13,690	292	324	18.9%	28.4%
Married No Children	22,325	17,879	329	365	17.7%	24.5%
Single Parent With Children	7,248	4,581	279	309	46.2%	81.1%
Other Households	11,906	11,279	367	407	37.0%	43.3%
TOTAL	15,828	11,737	312	348	23.7%	35.6%
Households Head 25 to 34						
Single	20,623	17,817	331	367	19.2%	24.7%
Married With Children	24,160	20,899	344	382	17.1%	21.9%
Married No Children	32,059	29,028	382	424	14.3%	17.5%
Single Parent With Children	10,965	7,271	319	354	34.9%	58.4%
Other Households	20,908	19,098	395	438	22.7%	27.5%
TOTAL	22,340	18,199	347	385	18.7%	25.4%
Households Head 35 to 44						
Single	19,282	19,934	325	360	20.2%	21.7%
Married With Children	26,715	23,793	363	403	16.3%	20.3%
Married No Children	30,200	29,749	359	398	14.3%	16.1%
Single Parent with Children	12,665	12,988	325	360	30.2%	32.7%
Other Households	16,999	19,288	325	360	22.9%	22.4%
TOTAL	21,963	20,357	343	375	18.8%	22.1%
Household Head 45 to 64						
Single	11,615	10,341	257	285	26.6%	33.1%
Married with Children	24,406	21,662	348	386	17.1%	21.4%
Married No Children	26,170	25,092	350	388	16.0%	18.5%
Single Parent With Children	12,013	9,961	310	343	30.9%	41.4%
Other Households	15,565	14,333	294	326	22.7%	27.3%
TOTAL	18,216	15,732	306	333	20.1%	25.4%
Household Head 65 or Older						
Single	6,300	6,409	203	225	38.6%	42.1%
Married	12,379	13,766	302	335	29.4%	29.0%
Other Households	11,160	10,457	257	285	27.5%	32.8%
TOTAL	8,836	8,540	238	257	32.4%	36.0%

Source: The State of the Nation's Housing 1988, Joint Center for Housing Studies of Harvard University, Appendix Table 11.

Technical Corrections to Tax Law Under Consideration

The principal tax-writing committee in the House of Representatives began consideration of the Technical Corrections Act (TCA) of 1988 on June 21. The House Ways and Means Committee under Chairman Dan Rostenkowski began making amendments to the bill which was introduced on March 31, 1988.

While the ostensible purpose of TCA is to correct drafting errors and clarify troublesome language in existing laws, the bill is likely to be the only vehicle for changes in tax laws that will be considered this year. Thus, committee members are amending the bill to include other substantive changes to the tax code and extension of the tax provision which are set to expire in the near future. Some of these amendments lose tax revenue and thus may need to be paired with revenue-generating amendments in order to limit the bill's impact on the federal budget.

Chairman Rostenkowski has circulated among the committee members a list of possible revenue-raising options. The committee, in its early deliberations, has identified five major revenue raisers. These five proposals are:

- Repeal of completed contract method of accounting. This provision affects mainly defense contractors.
- Accelerate corporate estimated tax payments.
- Repeal Alaska Native Corporations special rules for loss transfers. An accounting change which affects consolidated statements of loss for certain corporations.
- Reduce portfolio dividends received deduction in steps to 50 percent. This rule applies to corporations which own less than 20 percent of the stock of another corporation.
- Tighten restrictions on single-premium and investment-oriented life insurance and annuity products. This provision is aimed at curbing the use of these financial products as tax shelters. (See *Tax Notes* June 20, 1988, p. 1358-1359 and June 27, 1988, p. 1494-1497).

The bill alters the Mortgage Revenue Bond program to target the benefits to low-income households. These revisions are discussed in the next section. The Low-Income Housing Credit and the Unrelated Business Income Tax are also reviewed below.

MORTGAGE REVENUE BOND AND MORTGAGE CREDIT CERTIFICATE PROGRAMS

The TCA would extend the authorization of the states to issue qualified mortgage bonds and to trade-in bond authority in exchange for authority to issue mortgage credit certificates. Both programs would be extended through December 31, 1990.

Modifications

Several modifications would be made to the rules governing these programs to target their benefits to low-income households.

- The purchase price limit for assisted homes would be reduced to 75 percent of the average area purchase price (95 percent in targeted economically distressed areas).
- Income limits would be adjusted for family size as is done currently for multifamily rental housing bonds and for the low-income rental housing tax credit.
- Income limits would be determined by reference to area median incomes, and special adjustments would be provided (subject to a maximum limit of 140 percent and a minimum limit of 90 percent) for nontargeted areas having significantly higher or lower than national ratios of area median income to area purchase prices (so-called "high cost" or "low cost" areas).
- Issuers of qualified mortgage bonds and qualified veterans' mortgage bonds would be required to rebate arbitrage profits to the Federal Government under the rules that now apply to issuers of governmental and other private activity bonds.
- A three-year loan origination period would be imposed for qualified mortgage bonds. Undisbursed proceeds and prepayments (received during the three-year period) would be required to be used to redeem bonds no later than six months after expiration of the origination period. Prepayments received thereafter would be required to be used to redeem bonds no later than the close of the six month period following their receipt.
- An amount equal to the special subsidy provided by qualified mortgage bond-financing or an MCC (but not in excess of 50 percent of gain) would be recaptured on disposition of the house. Full recapture of this special subsidy would occur if the house were sold within 5 years; recapture would phaseout in years 6 through 10. A special rule would exclude from recapture part or all of the special subsidy in the case of assisted individuals whose incomes were less than prescribed amounts at the time of the disposition. The recapture provision would not apply in the case of home improvement loans. However, different versions of this recapture rule have been circulated among committee members. The exact formula may change before enactment.

THE LOW-INCOME RENTAL HOUSING TAX CREDIT

The tax credit may be claimed by owners of newly constructed, rehabilitated, and newly acquired existing residential rental property used for low-income housing. The credit is claimed annually, generally for a period of ten years. Credit percentages are adjusted monthly for buildings placed in service in that month to maintain a present value of the credit stream of 70 percent of qualified expenditures for most newly constructed and rehabilitated housing. A 30-percent present value is allowed in the case of acquisition of existing housing and of newly constructed or rehabilitated housing receiving other Federal subsidies, including tax-exempt bond financing.

To qualify for the credit, a low-income rental housing project must continuously comply with the requirements of the credit for a period of fifteen years after it is placed in service. The principal requirement is that a minimum percentage of housing units be continuously set-aside for use by individuals having incomes below prescribed levels. The minimum percentage is 40 percent for tenants having incomes of 60 percent or less of area median, or 20 percent for tenants having incomes of 50 percent or less of area median. A lapse in compliance with this or other Code requirements generally will result in the denial of the credit prospectively as well as a recapture of a portion of the tax benefits previously allowed, including an interest component to account for the time value of money.

The annual credit authority limitation for each state is equal to $1.25 for each individual who is a resident of the state. Ten percent of each state's credit authority is set aside for exclusive use for projects in which qualified nonprofit organizations participate. Credit authority is scheduled to lapse after December 31, 1989.

The TCA would extend present law through December 31, 1990. A conforming amendment would defer for one year the present-law provision permitting a limited carryover of the credit cap from the last year of the program into the following year.

The period since its inception shows a pattern of increased utilization of the low-income rental housing credit. An extension of the tax credit at this time will help to ensure continuity in the usage of this housing program, and will afford the committee an opportunity to gather more information on its operation and relative efficiency before deciding to continue, modify, or eliminate the program.

OTHER TAX MATTERS: UBIT

While the Technical Corrections bill was in the Congressional limelight, the House Ways and Means Oversight Subcommittee was considering a revision of the Unrelated Business Income Tax (UBIT). The UBIT is levied on the income from a subsidiary of a tax-exempt organization such as the gift shop income of a charitable hospital. The subcommittee is considering language to clarify which activities qualify as unrelated and how to calculate aggregate net income of the parent and subsidiary.

The subcommittee proposed to redefine the term "controlled organization" to refer to parent tax-exempt organizations that own more than a 50 percent interest in any subsidiary whether the measure is value or voting power. The subcommittee maintained that the taxable income of a controlled subsidiary should not be less than the UBIT amount would be if the subsidiary's income-producing activity had been carried on by the exempt parent.

The subcommittee proposed new rules to determine whether the primary purpose of an organization is tax-exempt when that organization owns subsidiaries that are not exempt. These recommendations focus on the activities and income of subsidiaries in which the parent has at least an 80 percent ownership interest.

The subcommittee proposed that in calculating the so-called aggregation rule, the IRS should: (1) compare the amount of attention given by exempt organization directors and staff to unrelated business activities and the organization's expenditures for exempt activities versus costs for taxable activities; (2) note the income derived from different activities; and (3) determine whether there is a reasonable expectation of earning a profit. (See *Tax Notes*, June 27, 1988, p. 1498-1499).

Kevin Yeats
Tax Economist
Forecasting and Policy Analysis Division

	QUARTERS							YEARS				
	Actual		Forecast					Actual		Forecast		
	1987.4	1988.1	1988.2	1988.3	1988.4	1989.1	1989.2	1986	1987	1988	1989	1990
AGGREGATE ECONOMY												
Gross National Product (billions of dollars)	4607	4669	4742	4815	4886	4962	5046	4235	4486	4776	5080	5398
% Change	7.6	5.4	6.4	6.4	5.9	6.4	7.0	5.6	6.0	6.4	6.3	6.2
% Change (w/out inflation)	4.8	3.9	2.9	3.0	2.4	2.4	3.0	2.9	2.9	3.6	2.6	1.9
Consumer Price Inflation (CPI)	3.6	3.6	4.5	4.7	4.4	4.7	4.8	1.9	3.7	4.2	4.2	5.1
GNP Inflation (GNP Deflator)	2.7	1.7	3.4	3.2	3.2	4.0	3.9	2.6	3.0	2.7	3.7	4.3
Unemployment Rate - Civilian	5.9	5.7	5.4	5.3	5.2	5.2	5.1	7.0	6.2	5.4	5.2	5.5
Civilian Employment-Household Basis (millions)	113.5	114.2	115.1	115.7	116.2	117.1	117.5	109.6	112.4	115.3	117.3	118.5
Percent change	2.3	2.5	3.1	2.1	2.3	2.5	2.0	2.3	2.6	2.4	1.7	1.0
Index of Industrial Production	133.0	139.6	141.3	143.1	143.8	144.2	145.4	125.1	129.8	136.6	139.6	140.9
Manufacturing Capacity Utilization	82.2	82.6	83.1	83.5	83.6	83.6	83.7	79.7	81.0	83.2	83.7	83.1
Domestic Auto Sales	6.7	7.6	7.2	6.9	7.0	7.0	7.0	8.2	7.1	7.2	7.1	6.9
Federal Tax Receipts (NIPA) as % of GNP	20.4	20.1	20.5	20.2	20.3	20.4	20.4	19.5	20.4	20.4	20.4	21.0
Federal Expenditures (NIPA) as % of GNP	24.0	23.9	23.6	23.7	23.8	23.7	23.6	24.4	23.8	23.7	23.6	23.5
Deficit (NIPA)	-165.9	-175.0	-156.6	-167.0	-171.3	-164.4	-158.5	-204.7	-152.8	-158.9	-163.6	-142.9
as % of GNP	-3.6	-3.8	-3.3	-3.4	-3.5	-3.3	-3.1	-4.8	-3.4	-3.3	-3.2	-2.6
REAL ESTATE MARKETS												
HOME SALES												
Total Single-family Home Sales (thousands, single-family resales plus 97 percent of single-family starts)	4447	4314	4536	4489	4352	4322	4418	4717	4649	4424	4342	4208
Percent change -- year ago	-12.2	-10.1	-3.4	-0.9	-2.1	0.2	-264	10.9	-1.4	-4.8	-1.9	-3.1
Existing Single-family Home Sales (1000)	3390	3250	3509	3410	3325	3280	3365	3565	3526	3374	3330	3236
Percent change -- year ago	-12.8	-10.3	-2.7	-0.9	-1.9	0.9	-4.1	10.9	-1.1	-4.3	-1.3	-2.8
Housing Starts (thousands)	1533	1477	1492	1542	1470	1477	1503	1805	1634	1495	1450	1363
Percent change -- year ago	-10.7	-16.9	-7.1	-4.7	-4.1	0.0	0.7	3.6	-9.8	-8.5	-3.0	-6.1
Single-Family Units	1090	1097	1059	1113	1059	1075	1086	1179	1157	1082	1065	1024
Percent change -- year ago	-6.2	-11.8	-6.9	-3.6	-2.8	-2.0	2.5	10.0	-1.9	-6.5	-1.6	-3.85
Multi-Family Units	443	380	433	429	411	402	417	631	477	413	385	338
2-4 Family Units	56	56	62	64	61	59	62	84	66	62	57	50
Percent change -- year ago	-35.9	-26.3	-13.9	16.4	8.9	5.3	0.0	-10.1	-21.2	-7.6	-6.6	-12.3
5+ Family Units	387	324	371	365	350	343	355	542	412	353	328	289
Percent change -- year ago	-17.1	-28.6	-6.3	-10.8	-9.3	5.9	-4.3	-5.9	-25.1	-14.3	-7.1	-11.9
New Single-family Home Sales (thousands)	621	626	670	651	621	627	647	750	671	642	622	534
Percent change -- year ago	-12.6	-11.9	-0.6	-3.4	0.0	0.2	-3.4	9.0	-10.1	-4.3	-3.1	-14.1
Mobile Homes Shipped (thousands)	232	207	212	199	194	193	191	249	233	203	187	174
HOME PRICES												
Existing Home Prices - Median ($1000)	85.0	87.3	88.3	91.0	91.6	92.1	94.1	80.3	85.6	89.7	94.0	98.9
Percent change -- year ago	6.0	3.2	5.7	6.7	7.8	4.9	6.6	6.4	6.6	4.8	4.8	5.2
New Home Prices - Median ($1000)	111.8	114.3	111.5	114.2	115.3	116.0	118.4	92.0	104.0	113.8	120.2	125.0
Percent change -- year ago	19.5	17.4	7.7	7.0	3.7	2.2	4.7	9.1	12.9	9.4	5.6	4.0
FINANCIAL MARKETS												
Long-Term Interest Rates												
30-yr FRM (FHA Secondary)	10.8	10.1	10.5	10.8	11.0	11.2	11.3	9.9	10.2	10.5	11.3	11.5
1-year ARM (without buydown)	8.2	7.5	7.3	7.3	7.5	7.7	8.0	7.9	8.2	7.4	8.0	8.5
Corporate AAA Bond Rate	10.2	9.6	9.9	10.0	10.2	10.3	10.5	9.0	9.4	9.9	10.7	11.0
Government Bond Rate	9.2	8.6	9.2	9.5	9.5	9.7	9.8	7.8	8.6	9.2	9.9	10.2
Short-Term Interest Rates												
Federal Funds Rate	6.9	6.7	7.1	7.2	7.3	7.3	7.5	6.8	6.7	7.0	7.5	7.8
3-month T-Bill Rate	5.9	5.8	6.3	6.4	6.5	6.7	6.8	6.0	5.8	6.2	6.9	7.1
Prime Rate	8.9	8.6	8.9	9.0	9.1	9.3	9.3	9.2	8.6	8.9	9.5	9.8
Discount Rate	6.0	6.0	6.0	6.3	6.5	6.8	7.0	9.2	8.6	6.2	7.0	7.3
Value of the U.S. Dollar (Trade-Weighted Avg.)	92.3	90.0	88.8	88.4	87.7	86.3	85.1	112.3	96.9	87.5	82.7	80.3
Percent change -- year ago	-13.8	-9.9	-8.4	-10.4	-5.0	-4.1	-4.2	-21.6	-13.6	-9.7	-5.5	-3.0

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo, Dr. Frederick Flick and Sean Burns.

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